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No. 988

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1964

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ALLIED CENTRAL STORES, INC., *Petitioner,*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

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## PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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Petitioner, Allied Central Stores, Inc., respectfully prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit entered in this case on December 17, 1964.

### OPINIONS BELOW

The findings of fact and opinion of the Tax Court of the United States are not officially reported but are unofficially reported at 23 T.C.M. 248 and ¶ 64-045

P-H Memo. T.C. The opinion of the Court of Appeals has not yet been officially reported but is unofficially reported at 65-1 U.S.T.C. ¶ 9123. As required by Rule 23, a certified copy of the transcript of proceedings below and of the Appendix record of the proceedings in the Tax Court of the United States together with nine additional copies of the latter is separately submitted herewith. The opinion of the Court of Appeals is printed hereinafter in Appendix A hereto.

## JURISDICTION

The judgment of the Court of Appeals was entered on December 17, 1964. Jurisdiction of this Court is invoked under 28 U.S.C. § 1254 (1).

## QUESTIONS PRESENTED

I. Whether under the decision of this Court in *Libson Shops, Inc.* v. *Koehler,* 352 U.S. 382 (1957), a single corporation which is continuously engaged in conducting one substantial business activity must be deprived of its statutory right to a net operating loss carryover, to which it would otherwise admittedly be entitled under section 23(s) and 122 (b)(2)(B) of the Internal Revenue Code of 1939, merely because it acquires by statutory merger assets of a commonly-owned corporation engaged in exactly the same business, where both the merging corporation and the surviving corporation were 100% owned subsidiaries of a common parent for a great number of years.

II. Whether the provisions of the Internal Revenue Code of 1954 or the provisions of the Internal Revenue Code of 1939 apply with respect to petitioner's net operating loss for its fiscal year ended January 31, 1954. If the provisions of the Internal Revenue Code

of 1954 apply, whether the decision of this Court in *Libson Shops, Inc.* v. *Koehler, supra,* bars use of taxpayer's 1954 loss against its 1955 and 1957 income.

## STATUTORY PROVISIONS INVOLVED

The statutory provisions involved are section 23(s) and 122(b)(2)(B) of the Internal Revenue Code of 1939 and sections 172, 381, 382, 393, 394 and 7851 of the Internal Revenue Code of 1954. These provisions are set forth in pertinent part in Appendix B, pages 5a to 17a, *infra.*

## STATEMENT OF THE CASE

Petitioner sustained net operating losses in the operation of its business for fiscal years ended January 31 as follows:

| | |
|---|---|
| 1951 | $ 1,377.99 |
| 1952 | 404,932.25 |
| 1954 | 93,589.84 |
| 1956 | 249,681.92 |

The petitioner's net taxable income, before the deduction of any net operating loss carryovers or carrybacks, was determined by the Commissioner of Internal Revenue for fiscal years ended January 31 to be as follows:

| | |
|---|---|
| 1955 | $243,371.77 |
| 1957 | 315,989.24 |

For the fiscal year ended January 31, 1953, the petitioner filed a consolidated return of income with its parent, Allied Stores Corporation, and other controlled subsidiaries of the parent. Upon such a consolidated return, the losses of 1951 and 1952 were not allowable as a deduction. The petitioner had no taxable income

for 1950 against which losses of 1951 and 1952 might have been applied as a carryback.

The petitioner was organized on February 27, 1939, as a wholly-owned subsidiary of Allied Stores Corporation. The parent corporation was organized in 1928 to establish and operate a nation-wide chain of department stores. It has conducted its business in part through the ownership and operation by it of department stores and in part through subsidiary corporations owned and controlled by it. Its stock was publicly owned and for many years prior to and including all years here involved was listed upon the New York Stock Exchange.

Upon its organization, Allied Stores Corporation acquired, among others, all of the capital stock of L. S. Donaldson Company and of The Golden Rule. In 1940, it acquired all of the capital stock of Heers, Inc. Each of the corporations named, including the petitioner and the parent corporation, were engaged in the operation of department stores.

On the dates stated, the corporations named were merged into the petitioner as follows:

October 31, 1953, Heers, Inc.
September 30, 1956, L. S. Donaldson Company
September 30, 1956, The Golden Rule

In each merger the petitioner was the surviving corporation. Subsequent to the merger and through the taxable year 1957 the petitioner continued to operate its original store and the stores previously operated by the merged corporations. At all times since its organization, the petitioner has been one of the wholly-

owned subsidiaries of Allied Stores Corporation and controlled by it.

Upon organization, the capital stock of petitioner consisted of 50,000 shares of common of the par value of $1 each and 3,000 shares of preferred of the par value of $100 each. This capitalization remained unchanged throughout all periods here involved. On financial statements included in tax returns, the assets and liabilities of the petitioner were increased by those of the merged corporations and the stated capital and surplus of the merged corporations were added to the surplus of the petitioner.

The corporate name of the petitioner was changed to Allied Stores of Missouri on October 31, 1953, when Heers was merged into it, and to Allied Central Stores, Inc. on September 30, 1956, when Donaldson and Golden Rule were merged into it.

Petitioner utilized its losses for 1951, 1952 and 1954 against its profits for 1955 and 1957 in its tax returns. The Commissioner, citing *Libson Shops, Inc.* v. *Koehler, supra,* disallowed the claimed net operating loss carryover deductions. Petitioner sought a redetermination of the resulting deficiency for fiscal year 1957 before the Tax Court of the United States on the grounds that the *Libson Shops* doctrine did not bar carryover of the losses from 1951, 1952 or 1954 under section 122 of the Internal Revenue Code of 1939 and in the alternative that carryover of the 1954 loss was governed by section 172 of the Internal Revenue Code of 1954 which the *Libson Shops* doctrine has no application. The Tax Court, in a memorandum opinion which was not reviewed by the full Court, upheld the Commissioner's determination on both issues. On the first

issue, the Tax Court memorandum opinion held that even though the same entity with the same owner was involved, the *Libson Shops* doctrine required that pre-merger losses could only be offset against income generated by the same assets which generated the losses and since taxpayer could not prove how much of the later income was attributable to the assets which generated the earlier losses, no carryover was allowable. In considering the second issue, the opinion indicates that the wrong statute was relied on by the Tax Court. The Court of Appeals for the Second Circuit upheld the Commissioner and the Tax Court. On the first issue, the opinion relies solely on the Second Circuit's earlier decision in *Julius Garfinckel & Co., Inc.* v. *Commissioner,* 335 F. 2d 774 (2d Cir. 1964), cert. denied ... U.S. ... (1965) without making any real effort to deal with the substantial differences between the two cases. The Court as an afterthought suggests that one may have to look to the possibility of changes of ownership of petitioner's parent because its stock is listed on the New York Stock Exchange to determine whether there is continuing ownership of the loss corporation. On the second issue, the Court of Appeals concluded that *Libson Shops, Inc.* v. *Koehler, supra,* applies to fiscal years ending after December 31, 1953 at least until June 22, 1954 when in the opinion of the Court sections 381 and 382 of the Internal Revenue Code of 1954 became applicable to mergers.

## BASIS FOR JURISDICTION IN THE LOWER COURTS

Jurisdiction of the Tax Court of the United States rests on 26 U.S.C. § 6214. Jurisdiction of the Court of Appeals for the Second Circuit rests on 26 U.S.C. § 7482.

## REASONS FOR GRANTING THE WRIT

There are three basic reasons why a writ should be allowed in this case.

1. The decision of the Second Circuit in this case erroneously decides a question of continuing importance both under the Internal Revenue Code of 1939 and under the Internal Revenue Code of 1954.

2. The decision is in direct conflict with the recent decision of the District Court for the Middle District of Georgia in the case of *Jackson Oldsmobile, Inc.* v. *United States*, ... F. Supp. ... (M.D. Ga. 1964), 65-1 U.S.T.C. ¶ 9113 (M.D. Ga. 11/13/64).

3. If the decision below is correct, it makes a mockery of sections 381 and 382 of the Internal Revenue Code of 1954.

## ARGUMENT

### 1. Petitioner's case presents the Court with a timely opportunity to settle several important questions concerning the application of and limitations on the Libson Shops decision under both the 1939 and 1954 Codes.

It has been almost eight years since this Court decided *Libson Shops, Inc.* v. *Koehler, supra.* During that time, fully 36 cases have been spawned, litigating various ramifications of the *Libson Shops* continuity of business enterprise theory. Most of these cases have involved various aspects of the question specifically reserved from judgment in now-famous footnote 9 of the *Libson Shops* opinion. The Internal Revenue Service has issued several rulings in an effort to interpret the theory and to give some bounds to it, but its rulings have been contradictory and confusing. This Court has thus far steadfastly refused to give guidance toward resolution of the important issues still outstand-

ing. The confusion has been generated not only in application of the theory to situations clearly within the facts of the *Libson Shop* case[1] but has arisen also because of the interpretation the Internal Revenue Service has given the decision and because of the attempt by the Service to extend the doctrine beyond the facts in that landmark case.[2]

The *Libson Shops* case involved a merger of 16 corporations owned and controlled by individual shareholders into a separate management corporation also owned by the same individual shareholders. Three of the merging corporations had net operating losses prior to the merger. This Court held that regardless of whether the surviving corporation was the "same entity" as the merging corporations, there was no continuity of business enterprise which would justify carryover of the pre-merger losses against post-merger profits. Footnote 9 expressly reserved judgment on

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[1] Neither the Internal Revenue Service nor the courts have given any guideline as to how profits of a particular segment of a taxpayer's business are to be applied against prior losses of that "business" when it was a separate entity. The only statutory rule is found in section 172 which deals with income and losses of taxpaying entities—not income or losses of a particular "business" operated by a taxpayer. This Court's pronouncement in *Libson Shops, supra*, cuts across the only statutory rule provided. Furthermore, no guideline has been issued by anyone as to how to determine the profits attributable to a particular "business", i.e., allocation of overhead, general expense, etc. It was not until 1959 when the Internal Revenue Service stated that taxpayers should maintain records from which income and expenses of the "business" could be derived. Rev. Rul. 59-395, 1959-2 Cum. Bull. 475, 479. This was two years after *Libson Shops* and six years after the transactions in question here.

[2] It is probably safe to say that more has been written about the *Libson Shops* decision than any other single tax case in recent years.

cases involving a single corporate entity which changes its business activities.

The Government in the cases since *Libson Shops* has taken the position that *Libson Shops* requires that net operating losses can only be carried over against income generated by the very same assets which generated the losses even in cases involving no change in the corporate entity and no change of ownership, as the Government's position in petitioner's case indicates. The Commissioner has thus attempted to push the *Libson Shops* concept far beyond any logical application. In doing so, the Commissioner has tended to defeat the original intent of Congress in adopting the loss carryover provisions.

The Commissioner's approach is that the net operating loss carryover and carryback provisions are some sort of special tax advantage to be narrowly construed. Far from it, these provsions were added to ameliorate the obvious injustice of application of the annual accounting concept in cases involving business losses during some periods and profits during others. Most businesses are expected to and do incur losses during at least some portion of their economical existence, especially in the early stages of development. Losses are in part sustained so that profits can be later earned. It is obviously unjust not to match the business losses against the resulting income. The net operating loss deduction is not special privilege legislation but is recognition of an obvious economic fact of life for most businesses. It was designed to offset an obvious, unjust tax detriment. The Board of Tax Appeals a number of years ago in *Northway Security Company* v. *Commissioner,* 23 B.T.A. 532, 535, (1931), pointed out that the carryover provisions were intended to be "relief"

provisions which should be liberally construed. It was only after people began abusing use of the carryover right by trading in loss carryovers that a restrictive view of the statuory right has become noticeable. It should be noted that where a single corporation is involved with the same ownership before and after any change in business takes place, there is no trading in loss carryover. This is the situation in petitioner's case.

As pointed out in *Norden-Ketay*:

> "Where there is a continuity of ownership, there might be justice in allowing a loss carryover even though there has been a complete change in the nature of corporate activity. The purposes of the statute are ultimately directed toward granting a legitimate tax advantage of the shareholders behind the corporate entity. See *Newmarket Manufacturing Company* v. *United States*, 233 F. 2d 493, certiorari denied, 353 U.S. 983 (1957)."

And again, as noted by Judge Aldrich in his penetrating dissenting opinion in *Collins* v. *United States*, 303 F. 2d 142, 149 (1st Cir. 1962):

> "But I might observe that I seriously question the correctness of the District Court's handling of *Libson Shops*. The subsequent lower court cases which have been decided against the taxpayers involve the change of ownership of the company along with the change in business. It would be one thing to prevent trading in tax losses by preventing a new party from acquiring a built in tax loss for a new business, but something else to say the taxpayer who has himself incurred a bona fide loss must lose the deduction if he changes the nature of his business."

It was obviously considerations such as these which gave this Court pause and prompted reservation of

judgment in the situations enumerated in footnote 9 to the *Libson Shops* opinion which stated:

> "9. We do not pass on situations like those presented in *Northway Security Company* v. *Commissioner*, 23 B.T.A. 532; *Alprosa Watch Corporation* v. *Commissioner*, 11 T.C. 240; *A. B. & Container Corporation* v. *Commissioner*, 14 T.C. 842; *WAGE, Inc.* v. *Commissioner*, 19 T.C. 249. In these cases a single corporate taxpayer changed the character of its business and the taxable income of one of its enterprises was reduced by the deductions or credit of another."

*A. B. & Container Corporation* and *Alprosa Watch Corporation* both involved a complete change of ownership and business activity. In *Northway Security Company*, the loss corporation sold its assets, changed its name, moved its office to another state and proceeded to engage in another business. There was no change of stock ownership. The Board of Tax Appeals in allowing the loss carryover characterized the carryovers provision as a relief provision which should be liberally construed. A similar situation is found in *WAGE Inc.* where a corporation engaged in selling cars changed its name and acquired a profitable radio broadcasting business as a result of a merger. The resulting corporation terminated the unprofitable automobile business four months after the merger. The Tax Court allowed the continuing corporation to carry over its unused excess profits tax credit incurred in the automobile business against the later radio broadcasting profits.

Petitioner's case involves the very situation which this Court must have had in mind in footnote 9. Here there is a *single* corporation with a *single* owner and

carrying on essentially the *same* business but on a larger scale after the change than before. There has been no trading in loss carryovers to give someone who has not economically borne the loss a "windfall".

While there have been numerous opportunities before this Court to resolve various questions reserved in footnote 9, the Court has not heretofore seen fit to consider any of them. For example, in the early case of *Mill Ridge Coal Company* v. *Patterson*, 264 F. 2d 713 (5th Cir. 1959), cert. denied 361 U.S. 816 (1959), a situation similar to *A. B. & Container Corporation* and *Alprosa Watch Corporation* arose. In the *Mill Ridge Coal Company*, the loss corporation sold off its coal assets and entered into a new oil transport business. It sought to offset its coal business losses against its oil transport business income. The District Court and the Fifth Circuit held there was no continuing business enterprise and relied primarily on the fact that there was a 100% change of ownership between the loss years and the profit years. However, a *single* corporation was involved. The *Libson Shops* holding did not literally cover this case. The taxpayer petitioned this court for a writ of certiorari but it was denied. See also *Virgnia Metal Products Company* v. *Commissioner*, 33 T.C. 788, aff'd 290 F. 2d 675 (3rd Cir. 1961), cert. denied 368 U.S. 889 (1961) and *Norden-Ketay Corporation* v. *Commissioner*, 319 F. 2d 902 (2d Cir. 1963), cert. denied 375 U.S. 953 (1964).

The refusal of this Court to give guidance to the lower courts in the application, limitation or extension of the *Libson Shops* doctrine to situations not precisely covered by *Libson Shops* has resulted in a current flood of cases under the provisions of the Internal Revenue Code of 1939 and, surprisingly enough, prom-

ises the same effect under the provisions of the Internal Revenue Code of 1954.[3] There are pending in the courts a number of cases involving issues presented in the present case. In *Federal Cement Tile Company* v. *Commissioner*, 40 T.C. 1028, aff'd ... F. 2d ..., 64-2 U.S.T.C. ¶ 9863 (7th Cir. 1964), the Court of Appeals for the Seventh Circuit has applied the *Libson Shops* continuity of business enterprise doctrine to bar carryover of losses incurred in a cement tile business primarily conducted in the East against the same corporate entity's income from the same business in later years where primarily conducted in the middle West. In that case, an almost complete change of ownership took place as a result of a merger. In *Frederick Steel Company*, 42 T.C. 13 (1964), aff'd ... F. 2d ... (7th Cir. 1965), the Seventh Circuit refused to allow losses incurred in a beer and ice business to be offset against a later acquired steel business where there was a complete change of ownership and discontinuation of the beer and ice business. In *The Humacid Company*, 42 T.C. 894 (1964), the Tax Court applied the *Libson Shops* doctrine to bar carryover of losses by a single corporation incurred in the acid business against later profits from another business after the stock ownership changed as a result of a 25% shareholder buying out the other 75% ownership. In *Jeremiah J. O'Donnell, Jr.* v. *Commissioner*, T.C. Memo. 1964-38, 23

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[3] Cases which have applied the *Libson Shops* theory to the 1954 Code include *Arthur T. Beckett* v. *Commissioner*, 41 T.C. 386 (1963), appeal docketed in Ninth Circuit; *J. G. Dudley* v. *Commissioner*, 298 F. 2d 750 (4th Cir. 1962); *Huyler's* v. *Commissioner*, 327 F. 2d 767 (7th Cir. 1964); *Gulf Realty and Insurance Co.* v. *Tomlinson*, 63-1 U.S.T.C. ¶ 9174, 11 AFTR 2d 465 (M.D. Fla. 1962); *cf. Jackson Oldsmobile, Inc.* v. *United States*, 65-1 U.S.T.C. ¶ 9113 (M.D. Ga. 1964); *Calvin* v. *United States*, .... F. Supp. ...., 65-1 U.S.T.C. ¶ 9112 (D. Colo. 1964).

T.C.M. 210 (1964), the Tax Court refused under the *Libson Shops* doctrine to allow a single corporation to carry over losses incurred in the manufacture and sale of men's clothing against later profits incurred in the same location in the manufacture and sale of women's clothing where there was a complete change of ownership of the loss corporation. In the *O'Donnell* case, a family partnership purchased the stock of the loss corporation and then caused a profitable corporation to merge into the newly-acquired loss corporation. In *Fawick Corporation* v. *Commissioner*, T.C. Memo. 1964-65, 23 T.C.M. 194 (1964), aff'd ... F. 2d ... (6th Cir. 1965), again the Tax Court under the *Libson Shops* doctrine refused to allow a single, continuing corporation to carry over losses it had incurred in the brake manufacturing business against later profits generated in the motor bus business acquired by merger where majority control of the loss corporation was transferred to the shareholders of the profit corporation in the merger. See also *Foremost Dairies, Inc.* v. *Tomlinson*, ... F. Supp. ..., 63-2 U.S.T.C. ¶ 9648 (M.D. Fla. 1963), aff'd ... F. 2d ... (5th Cir. 1965).

Admittedly, each of these cases involved a complete change of business activity and a complete or almost complete change of stock ownership with the corporate entity as the only connecting link. It may be that the decisions of the lower courts are considered correct on the facts even though there was a continuing single corporation, but the failure of this Court to finally resolve this issue has left it hanging in the air for eight years.

A more difficult case arises where there is little or no change of ownership of a single corporation which changes its business as in *Northway Security Company*

or where a single corporation's business is not changed but its ownership is changed between the loss and profit years. In *Kolker Brothers, Inc.* v. *Commissioner,* 35 T.C. 299 (1960), Government's appeal dismissed (4th Cir. 1961), the Tax Court of the United States had before it a case of a loss corporation acquiring a new business by, in effect, issuance of 46% of its common stock. A single corporate entity was involved. The Court found that the new hotel supply business was not substantially different from the restaurant supply business in which the losses had been incurred. The change of ownership saw the shareholders who owned 100% of the stock of the corporation during the period of losses reduced to 54% of the stock of the corporation during the period of profits with the enhanced business. In view of these facts, the Tax Court held that the *Libsons Shops* doctrine did not bar carryover of the corporation's losses against its later profits. The Commissioner did not follow through its appeal in this case but has since refused to acquiesce in the result. Non-acquiescense noted, 1963-2 Cum. Bull. 6. Since there was no appeal, this Court had no opportunity to deal with the *Kolker Brothers* situation where there was only a change of minority ownership and an addition of related business of the same type previously carried on.

This Court did have the opportunity in the past few months to deal with a case involving a single corporation whose ownership changed as a result of merger of a related corporation where the common owner's percentage of ownership increased from 58% to 95%. *Julius Garfinckel & Co., Inc.* v. *Commissioner,* 335 F. 2d 744 (2d Cir. 1964), cert. denied, ..., U.S. ... (1965). The principal shareholder of the continuing

loss corporation in that case owned 58% of the stock at the time of the losses and 95% of the stock at the time of the profits. The Court of Appeals for the Second Circuit noted with regret the obvious justice of allowing the losses where the principal owner in effect suffered 58% of the losses and sought to recoup them against 95% of the later profits. Unfortunately, by denying certiorari, this Court lost the opportunity to give guidance on the issues of the effect of continuation of the loss corporation, the effect of the substantially similar but enhanced business after the merger, or the effect of the change of ownership affecting only a minority interest.

The *Garfinckel* case differs slightly from the *Kolker Brothers* case because in *Kolker Brothers* the shareholders who suffered 100% of the losses were allowed to recoup 54% of the losses by allowing carryover of the losses against later income. In *Garfinckel,* the shareholder who stood only 58% of the losses was attempting to derive benefit to the extent of 95%.

In each of these cases, a single continuing corporation is involved. The Supreme Court has never authoritatively stated whether the continuity of business enterprise theory applies at all to such situations. As noted, footnote 9 of the opinion in *Libson Shops* reserves this question. This question is presented in petitioner's case. Even if the *Libson Shops* doctrine does apply to a single continuing corporation, the Supreme Court has never authoritatively stated what constitutes continuation of the business enterprise, i.e., whether continuation of the same business, but enhanced by addition of a similar operation, qualifies under the 1939 Code as it presumably does under section 382(a) of the 1954 Code. This case involves that

question. Again, if the *Libson Shops* doctrine applies to a single continuing corporate entity, the Supreme Court has never authoritatively stated whether the fact that there is no change of ownership makes a difference. Petitioner submits that this fact does make a difference and this case presents the Court an opportunity to say so.

**2. The decision below directly conflicts with the decision in Jackson Oldsmobile, Inc. v. United States.**

In *Jackson Oldsmobile, Inc.* v. *United States, supra,* the District Court for the Middle District of Georgia decided that a corporation which liquidated its assets, then remained relatively inactive for a period of time and later recapitalized, changed its name and relocated, could carry over net operating losses and deduct them from profits earned after the recapitalization where there was a continuity of majority stock ownership, the legal entity of the taxpayer was unchanged, and the taxpayer corporation continued essentially the same business though in another location. In that case, the corporation, all of the voting stock of which was owned by General Motors and all of the non-voting stock by the "dealer", was in the business of operating a Buick dealership in Lamar, Colorado. The corporation sustained losses in 1953 and 1954. The corporation then began liquidation proceedings leaving the corporation basically a shell with ownership in General Motors Corporation. Later, a new dealership was organized in Macon, Georgia. The new dealer was allowed to purchase the non-voting stock of the shell corporation. General Motors continued as owner of all of the voting stock, which accounted for approximately 60% of the outstanding stock of the corporation. General Motors granted an Oldsmobile franchise to the

corporation. After creation of the new dealership, the corporation operated at a profit and sought to offset its Buick dealership losses against its Oldsmobile dealership profits. The Court distinguished the earlier single corporation cases where the *Libson Shops* doctrine had been applied on the ground that in each of these earlier cases, a new and entirely different business was carried on after a complete or almost complete change of ownership. The Court then found that operation of the Oldsmobile dealership was substantially similar to operation of the Buick dealership and that majority ownership continued in General Motors so that it, in effect, suffered the losses before and enjoyed the income after the changes.

The *Jackson Oldsmobile, Inc.* decision represents a direct conflict with the decision of the Court of Appeals for the Second Circuit in petitioner's case. In petitioner's case, there is the single, continuing corporate entity. There is complete ownership before and after the changes. There is continuation of the previous business enhanced by addition of substantially similar business operations, albeit in additional locations. The only difference, and this is a distinction without a difference, is that the principal asset in *Jackson Oldsmobile,* the Oldsmobile franchise, was contributed by the parent, General Motors Corporation, to the subsidiary, whereas in petitioner's case the additional assets were transferred to petitioner by way of merger of a wholly-owned subsidiary into petitioner. This is a distinction without a difference because it should make little difference how the parent places additional assets in the subsidiary assuming that valid business purpose for doing so exist. In this connection, Allied Stores Corporation could have liquidated the profit subsidiary tax

free under section 112(b)(6) of the Internal Revenue Code of 1939 and later contributed the assets to the loss subsidiary. Or, Allied Stores Corporation could have contributed the stock of the profit subsidiary to petitioner and petitioner could have then liquidated the profit subsidiary and there would be no question but that in either event petitioner would be entitled to carry over its previous losses against its later profits.

One further point of conflict between *Jackson Oldsmobile, Inc.* and petitioner's case is that no point whatsoever was made by the District Court that General Motors Corporation's stock was actively traded on the New York Stock Exchange. The Court obviously considered General Motors Corporation itself as the shareholder of its subsidiary's stock for purposes of determining whether the continuing owner economically suffered the losses as well as enjoyed the later income. In petitioner's case, the Court of Appeals for the Second Circuit, somewhat as an afterthought, pointed out that the possibility exists that the individual shareholders who could be said to have sustained the burden of the earlier losses might not be the same stockholders during the period of later income. It might be pointed out that there is no evidence in the record whether there were any sales of Allied Stores Corporation stock during the periods in question. The stipulated fact states only that the stock was listed on the New York Stock Exchange. It might also be added that majority control of Allied Stores Corporation probably was not traded in any event because the great bulk of its stock is and has been for a number of years in the hands of institutional investors.

**3. The decision below conflicts in principle with the statutory structure under the Internal Revenue Code of 1954 which is applicable to petitioner's loss for its fiscal year ended January 31, 1954.**

The decision below in petitioner's case when coupled with the possibility that the *Libson Shops* doctrine carries over under the 1954 Code would make a mockery of sections 381 and 382 of the 1954 Code. Section 381, *inter alia,* provides that net operating loss carryovers under section 172 are taken into account by the acquiring corporation in a transfer to which section 361 applies including mergers and C, D and F reorganization. If the *Libson Shops* doctrine operates as a limitation on section 172 as it does on section 122 of the Internal Revenue Code of 1939, and the cases listed in footnote 3, *supra*, p. 13 indicate that it does, there will be no net operating loss carryovers to take into account under section 381(a). The same would be true of section 382(a). This section is designed to bar use of net operating loss carryovers by a single continuing corporation whose stock ownership substantially changes within a relatively short period of time by a sale when coupled with a change in trade or business. In *Jackson Oldsmobile,* section 382(a) would have allowed carryovers, but if, again, *Libson Shops* bars the carryovers in the first place, there is nothing on which section 382(a) can operate. The same is true of section 382(b). If in a merger the transferor corporation or the acquiring corporation has a net operating loss carryover and the stockholders of the loss corporation own less than 20% of the fair market value of the outstanding stock of the acquiring corporation, the net operating loss carryover is cut back by 5 percentage points for each percentage point less than 20% owned by the former shareholders of the loss corporation.

But if there are no loss carryovers as a result of the *Libson Shops* doctrine, section 382(b) is an exercise in futility. Section 382(b)(3) provides that the limitation does not apply at all if the transferor and the acquiring corporation are owned substantially by the same presons in the same proportion. Quite obviously, Congress had in mind no cutback of net operating losses where the corporations were owned by the same persons in the same proportion, as is the case with Allied Stores Corporation, and its wholly-owned subsidiaries which were merged in petitioner's case.

The Commissioner has in part recognized the absurdity of attempting to apply the *Libson Shops* doctrine in cases to which section 381(a) applies. Rev. Rul. 58-383, 1958-2 Cum. Bull. 149; Rev. Rul. 59-395, 1959-2 Cum. Bull. 472. He has gone further and specified that a single, continuing corporation can acquire by purchase from outsiders a new business and can thereupon discontinue the old business without disallowance of its loss carryovers where there is no change of ownership. This applies apparently to the years governed by the Internal Revenue Code of 1939 as well as those governed by the Internal Revenue Code of 1954. Rev. Rul. 63-40, 1963-1 Cum. Bull. 46. Even the Commissioner has thus indicated that where there is no change of ownership, a corporation should be entitled to acquire a new business by use of its own resources or by use of those contributed to it by its parent. As a matter of fact, in the companion case which was filed by another subsidiary of Allied Stores Corporation, *D. M. Read, Inc.* v. *Commissioner*, Docket No. 1535-62, the Commissioner stipulated entry of judgment of no deficiency for the taxpayer's fiscal year ended January 31, 1954 where Allied Stores Corporation purchased a new profitable business in 1953

from an outsider and then contributed the assets to its loss subsidiary. Obviously, there was no change of ownership. Apparently in relying on Rev. Rul. 63-40, *supra*, the Commissioner agreed that a contribution of a new business to a wholly-owned subsidiary does not result in disallowance of carryovers under section 122 of the Internal Revenue Code of 1939. It seems odd that the Commissioner would continue to litigate the case where a parent corporation has simply contributed a profitable subsidiary's assets to a loss subsidiary by way of merger as in petitioner's case. Admittedly, there were business reasons for the merger in the present case. The point is that reshuffling of wholly-owned subsidiaries by merger, or capital contribution, motivated by important business considerations, should not bar use of carryovers under by the *Libson Shops* doctrine, as they are not barred under section 382 of the Internal Revenue Code of 1954.

The provisions of the Internal Revenue Code of 1954 would allow carryovers to a single corporate entity, even though complete ownership of stock changes so long as the business does not change. Section 382(a). It would allow a complete change of business so long as there is no change of ownership. It makes no distinction between acquisition of assets by way of merger or other reorganization or liquidation. But, these provisions assume that there are net operating loss carryovers available. If the *Libson Shops* doctrine applies, in many instances there would be no net operating loss carryovers on which these provisions could apply. While the Commissioner has said that he would not apply the *Libson Shops* doctrine in mergers under the 1954 Code, is this because of administrative fiat, because Congress has changed the law, or because the *Libson Shops* doctrine did not apply under the circumstances of petitioner's case even under the 1939 Code?

The second issue presented in this petition explores the applicability of the *Libson Shops* doctrine to a 1954 Code year. The key question is whether or not the provisions of the Internal Revenue Code of 1954 apply with respect to a merger which took place on October 31, 1953 where the taxpayer's fiscal year straddles January 1, 1954. Petitioner's position is that the provisions of section 172 covering the straddled situation make it clear that petitioner's net operating loss for the fiscal year ended January 31, 1954 is carried over in accordance with the provisions of the Internal Revenue Code of 1954. Because of the inconsistency between the *Libson Shops* doctrine and the statutory scheme under the 1954 Code, petitioner's position is that the *Libson Shops* doctrine does not apply under the Internal Revenue Code of 1954.

This position rests on the applicability of sections 381 and 382 to petitioner's situation. Neither the Tax Court of the United States nor the Court of Appeals for the Second Circuit in the proceedings below noted that sections 381 and 382 can apply to mergers taking place prior to June 22, 1954. The effective date provisions in sections 393 and 394 of the Internal Revenue Code of 1954 quoted in pertinent part in Appendix B, *infra,* make it clear that there are exceptions to the June 22, 1954 date. Section 172 operates with respect to straddle-year taxpayers, such as petitioner. Section 381(c) is dependent on section 172. Consequently, the effective date of the reorganization provisions under section 393(a) and the effective date of sections 381 and 382 are dependent on the effective date of section 172. This is an exception and appears in subchapter C. Consequently, the Internal Revenue Code of 1954, including sections 172, 381 and 382, applies to the net operating loss for the fiscal year ended January 31, 1954 and the Court is then faced with the issue

whether the *Libson Shops* doctrine applies to mergers governed by provisions of the Internal Revenue Code of 1954. This alternative position, of course, need not be reached if petitioner's principal position is sustained.

In summary, the grounds upon which petitioner relies in this petition for a writ of certiorari are:

1. The decision of the Court of Appeals for the Second Circuit in this case erroneously decides a question of continuing importance both under the Internal Revenue Code of 1939 and under the Internal Revenue Code of 1954.

2. The decision is in direct conflict with the recent decision of the District Court for the Middle District of Georgia in the case of *Jackson Oldsmobile, Inc.* v. *United States, supra.*

3. If correct, the decision makes a mockery of sections 381 and 382 of the Internal Revenue Code of 1954.

Respectfully submitted,

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